

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 00-0477

**Corporate Gross Income Tax
For Tax Years 1997 through 1998**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superceded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Corporate Gross Income Tax—Services

Authority: 45 IAC 1.1-2-5

Taxpayer protests the auditor's determination that income related to the outsourcing services taxpayer provided in Indiana was subject to tax.

II. Tax Administration—Abatement of Penalty

Authority: IC 6-8.1-10-3

Taxpayer protests imposition of a twenty percent (20%) penalty for taxpayer's failure to file income tax returns.

STATEMENT OF FACTS

Taxpayer is an out-of-state corporation that provides outsourcing services to both industry and government through the management of its clients' information technology systems. Taxpayer provides personnel, and in some instances equipment, necessary to meet its clients' information technology needs. In November of 1996, taxpayer entered into a long-term contract with an insurance management firm (hereinafter, "the Firm") to perform outsourcing services. As the Firm is a multi-national corporation, the contract impacted Firm operations in the United States and Canada. The value of the contract was placed at approximately \$250 million.

Upon entering into the contract with the Firm, taxpayer acquired assets located in Indiana. The assets included software license agreements and related hardware. These assets were slated to be relocated to California (the state in which taxpayer is commercially domiciled); however, the software vendor would not allow the software to be relocated to another state. Based upon the

foregoing, taxpayer decided to leave the software at the Indiana location. This decision required that office space be rented and support personnel be hired to manage the software. Upon completion of the contract, the Indiana office was closed.

During the years in question, taxpayer did not file any Indiana income tax returns, as taxpayer classified said Indiana office location as "non-revenue recognizing." The Department of Revenue conducted an audit for taxpayer's fiscal years 1997 and 1998, and issued various tax assessments against taxpayer, including a twenty percent (20%) non-filer penalty. Additional facts will be supplied as necessary for discussion.

I. Corporate Gross Income Tax— Services

DISCUSSION

Taxpayer states in its protest letter, dated November 30, 2000, that the only assets that it maintained in Indiana were those assets that were acquired with the contract that taxpayer entered into with the Firm. As such, taxpayer viewed the Indiana office (and the assets contained therein) as a support facility only, and not a revenue generating facility. The payments that the Firm made to taxpayer for the services rendered were lump sum payments; and, all revenue received from the contract was allocated to California, the state in which taxpayer is commercially domiciled.

Taxpayer based its decision to allocate all of the revenue received from the contract to California on a determination by taxpayer that revenue attributable to Indiana (based upon the services provided in Indiana under the terms of the contract) amounted to less than five percent (5%) of the total revenue received under the contract in each of the years in question. The auditor determined that because taxpayer had property (an office) and payroll (employees that operated the office) in Indiana, the income related to the services taxpayer provided in Indiana was subject to tax.

It is well-settled that "[g]ross income derived from the provision of a service of any character within Indiana is subject to the gross income tax." 45 IAC 1.1-2-5(a). However, this regulation goes on to provide that:

(e) When a contract provides for the provision of services in a state besides Indiana, gross income derived from the provision of services within Indiana will be determined by multiplying the gross income derived from the contract by the ratio of Indiana activities to total activities provided under the contract. The activities used will be only those related to the services performed and reasonably calculated to effectuate an equitable allocation and apportionment of the taxpayer's gross income under the contract. However, if the percentage of Indiana activities to total activities under the contract is less than five percent (5%), then the entire proceeds of the contract, received in that year are exempt from the gross income tax.

Taxpayer argues that because the revenue allocated to Indiana falls below the five percent (5%) floor, the tax assessed against said revenue should be eliminated.

However, the evidence on file establishes that the agreement with the Firm to provide technology outsourcing was made up of numerous outsourcing contracts located all over the United States and Canada. Taxpayer's Indiana income resulted from a contract for the performance of technology outsourcing services within Indiana. To fulfill the contract, perform the services, and maintain the software and assets taxpayer acquired when it entered the contract, taxpayer rented office space and hired personnel.

The purpose of the 5% rule set forth in 45 IAC 1.1-2-5 is to avoid taxing the proceeds of contracts involving minimal activities in Indiana. Although the Indiana revenue from the contract allocated to Indiana was relatively small compared to the total net worth of the taxpayer's business with the Firm, taxpayer's activities within Indiana under the contract were more than minimal or incidental. As such, the auditor did not err in determining that the income from the performance of services within Indiana under the contract were subject to gross income tax.

FINDING

Taxpayer's protest is denied.

II. Tax Administration— Abatement of Penalty

DISCUSSION

Taxpayer protests the imposition of a twenty percent (20%) penalty for failure to file Indiana income tax returns. IC 6-8.1-10-3 states that if an entity fails to file a return, the Department may prepare a return for said entity. If the Department prepares an entity's return under this section, the entity is subject to a penalty of twenty percent (20%) of the unpaid tax.

Taxpayer failed to file Indiana returns as required. The Department assessed a penalty for the failure to file returns. Taxpayer has not shown reasonable cause for its failure to file Indiana returns.

FINDING

Taxpayer's protest is respectfully denied.